The Future of Regulation

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ABSTRACT

This paper discusses the prevalence of regulation in the U.S. It provides the necessary background information on the process for creating regulations, how scholars can measure the increase in regulation, and the different types of regulations. This paper then goes on to discuss the five major recent trends in regulation and the implications of these trends for the future.

I. INTRODUCTION

Do you feel regulated? On a business trip, your day might start by being woken up, not by the alarm clock, but by a phone. For that call to go through on a cell phone, the phone company had to buy a license from the Federal Communications Commission (FCC) to use part of the radio spectrum. There are various rules and regulations governing how that spectrum came into being and how it is used. Moreover, the tag on your mattress assures that the mattress complies with Title 16 of the Code of Federal Regulations, section 1633, which deals with flame retardant, fire proof mattresses.[1] Then you get up and go into the bathroom, you take out your FDA approved toothbrush, put FDA approved toothpaste on it, and brush your teeth.[2] You might then reach for a can of shaving cream containing only two and a half ounces because, if you flew on a plane, regulations from the Department of Homeland Security prevent anyone from carrying a full size can of shaving cream on an airplane.[3]

Not all of this is necessarily a reason to complain. Your cell phone company was required to obtain a license to use the spectrum, which it bought it at an auction run by the FCC. Auctioning has proven to be a much better method of allocating spectrum than some of the other methods previously used by the FCC.[4] Few people would object to the idea of sleeping on a mattress that is flame retardant. While that regulation may not be objectionable, some might consider themselves competent enough to find safe toothbrushes and toothpaste and most people would like to know what

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information the Department of Homeland Security relied on to construct its regulations regarding carry-on luggage.

Simply put, federal regulation touches everyone's daily lives in many ways that most people never bother to think about. Because regulation is extremely pervasive, it makes sense to learn more about how federal regulation works, what it does, and to think carefully about the process of adaptation and review of regulations.

II. How Regulations Are Created

Many times in casual conversation the term 'regulation' is used to refer to any restriction imposed by the government that defines certain actions as legal or illegal, but the definition is actually more specific. Regulation occurs when a legislature delegates some of its lawmaking power to a regulatory agency, which then issues detailed rules, the purpose of which is to carry out the intention of the legislature. Regulations are issued by a regulatory agency, with the intention of filling in the gaps in legislation. In the case of federal regulation, it fills in the gaps left by the U.S. Congress.

Two kinds of regulatory agencies exist at the federal level in the United States. Many regulatory agencies are actually part of the executive branch and their top officials are hired and can be fired by the President. These include agencies, such as the Environmental Protection Agency, the various agencies that regulate transportation within the Department of Transportation, and any position within a Cabinet department. All these regulatory agencies are directly responsible to the President.

There are also independent regulatory agencies, that is, agencies that are independent of the President, but not independent of Congress. These agencies usually have the word "commission" in their title. The President usually appoints the commissioners, who run these agencies for a fixed term, with the consent of the Senate. The President cannot fire them, and as a result, these agencies tend to function relatively independently of the executive branch. They do not necessarily act independently of Congress, since Congress ultimately approves the budget and writes the laws that the agencies are supposed to implement. Examples of this type of agency are the FCC, Consumer Product Safety Commission, Security and Exchange Commission, and Commodity Futures Trading Commission. The Federal Reserve is also considered an independent regulatory agency.

The most significant difference between the independent agencies and the executive agencies is that executive agencies are supposed to operate within rules laid out in executive orders. Democratic and Republican administrations issue executive orders and these orders explain how agencies ought to analyze regulations. The White House has the ability to tell these agencies, "No, you can't issue that regulation, because you haven't done your homework." The independent agencies, on the other hand, have not traditionally been subject to that kind of oversight by the White House.

Regulations are made through an organized process. There must be authorization in legislation for a regulatory agency to enact a piece of regulation, and it must be empowered to issue a particular regulation by Congress. The agency must issue any proposed regulation for public comment, and it will take comments on the proposed regulation for an average of sixty to ninety days. It will then rewrite the proposed regulation, and issue its final regulation. The regulation may go through several rounds of proposals and revisions. The Office of Management and Budget (OMB) reviews regulation produced by executive agencies, both before it is released for comment and before it is officially published. Finally, before any agency publishes a regulation, Congress is able to review that regulation. Although Congress could nullify any regulation at any time, it also has an expedited process for reviewing regulations under the Congressional Review Act. This Act allows Congress the power to quickly veto a proposed regulation or to veto a final regulation after it is published by the passage of a joint resolution by a simple majority.[5] The Congressional Review Act has only been invoked once in history.

Finally, regulations can be appealed to the courts. When one is affected by a regulation, one can seek reprieve from the courts if a regulatory agency exceeded its authority, the regulation is arbitrary, or the process of creating the regulations is flawed. Regulations must be in accordance with certain rules. There is an organized process for issuing regulations, and there are opportunities at various points for members of the public, to have some effect on what regulatory agencies do.

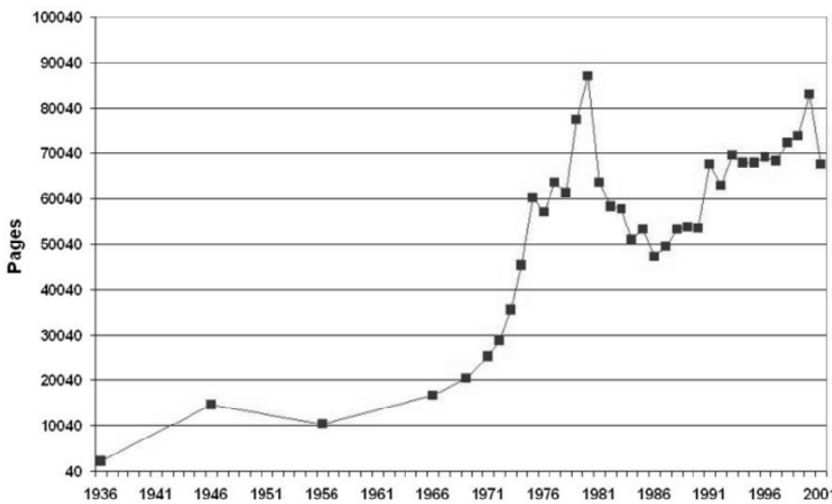
As individual citizens or as members of other organizations, the public can comment on proposed regulations to the OMB when it is reviewing a regulation. The public can make its views known to Congress, which ultimately writes the laws, and, if someone is directly affected by the regulation, he or she may have standing to challenge that regulation in court. If someone else challenges a regulation in court, a citizen can file an amicus brief, or friend of the court brief, offering some information or commentary on the regulation.

III. HOW MUCH REGULATION IS THERE ON THE FEDERAL LEVEL?

There are many ways of measuring regulation, and all of them are inaccurate. Do not take the evidence too seriously, or literally. Measures of regulation reveal the big picture, and whether regulation has been increasing or decreasing. Other than that, these measurement methods are all inexact.

Traditionally scholars have tried to measure the amount of regulation by the number of pages in the Federal Register (Figure 1), because the Federal Register is where agencies have to publish most proposed regulations and where they have to publish final regulations. This method does not necessarily measure the volume of effective regulation because deregulatory action, as well as regulatory action, must go into the Federal Register. However, it does give a decent idea of the total amount of regulatory activity that agencies engage in.

FIGURE 1: PAGES IN THE FEDERAL REGISTER: 1936–2001



Source: UCSD Vote View[6]

Regulatory activity increased during the World War II, and increased again in 1972. In President Nixon's second term, it ramped up tremendously, hitting a peak in the final year of the Carter presidency, and falling somewhat under President Ronald Reagan. Regulation resumed growth under President George H.W. Bush, continued growing under President Clinton, and then leveled off under President George W. Bush.[7]

There are other ways to looks at regulatory trends. One technique is to look at regulatory agency expenditures in the Federal Budget. These do not measure the total cost of regulation; they only measure what the Federal Government is spending to administer regulations. In both of these measures, there is actually a similar pattern, showing where regulation has waxed and waned, sometimes rapidly, sometimes slowly. Once again, by this measure there is a bit of a dip during the Reagan years, and then a huge spike under President George W. Bush, which most largely reflects the increase in regulations regarding national security.[8]

Similarly, by counting the number of people in the Federal Government, who are involved in regulation, follows a pattern somewhat similar to the pattern of expenditures. There is a big jump right after 2001.[9] That reflects the federalization of the air traffic screening force. Private contractors, who worked for the airlines, formerly conducted airport security, but the Federal Government took over screening and this added approximately sixty-thousand federal employees.[10]

These measures generally track each other, albeit imperfectly. During the Nixon and Carter years, the amount of regulatory activity increased faster than the amount of spending. This is also demonstrated by graphing the number of personnel. In terms of Federal Register pages, federal regulators became more productive during the Nixon and Carter years because they were able to produce more pages per person. Regulation has gradually been growing, but there have been some fluctuations in the trend. This fluctuation is evident when examining the number of Federal Register pages versus the number of regulatory staff.

Another way of measuring the amount of regulation is by looking at the total cost against the total benefit of regulation. There are several ways of measuring this and all of them are inaccurate. One of the best ones comes from the Office of Information and Regulatory Affairs within the OMB. Every year they are required by law to produce an annual estimate of the costs and benefits of federal regulations. The estimate they released in 2009 said that the benefits of regulation are somewhere between \$126 billion and \$663 billion, and the costs are between \$51 and \$60 billion. However, this is not the total benefit and cost of all federal regulations. Rather, this is the total benefit and cost of federal regulations proposed within the past ten years. The total will arguably be a lot higher on both the cost side and the benefit side.

The other odd thing about the OMB estimate is the method behind the estimation. The estimate uses the cost and benefit projections that were calculated by federal agencies when they proposed these regulations. In reality, this is a measure of the costs and benefits that agencies anticipated when they proposed the regulations. This is not a measure of the actual costs or the actual benefits that occurred after the regulations were implemented. However, the officials that author the report acknowledge these shortcomings.

Another attempt to measure the cost of regulation is undertaken by the Small Business Administration's Office of Advocacy. The Office of Advocacy promotes regulation polices that benefit small businesses. They commission an academic to report on the total cost of federal regulation and examine how it affects small businesses verses large businesses. Professor Mark Crain led the most recent report which estimates that the total cost of regulation is around a $1 trillion or $10,000 per household.[11] The study has been criticized on a number of grounds, but the picture, from either the OMB figures or Mark Crane's study, indicates the substantive effect of regulation, regardless of the problems in the studies.

IV. TYPES OF REGULATION

There are different types of regulations. Economic regulation involves government control of prices, entry, setting quality standards for products and services, and establishing other contract terms, but that is not the most common type of regulation. Health and safety regulation is the largest single portion of regulation in terms of federal activity. Workplace health and safety regulations or other kinds of health and safety regulations, such as all of the Homeland Security regulations are intended to make people healthier or safer. An FDA approved toothbrush is an example of a health and safety regulation.

There are also environmental regulations. Some are intended to improve health and safety, such as getting particulates out of the air because .particulates can cause significant health problems. But, other environmental regulations are not as linked to human health and safety and come from to a broader desire to protect the environment. For example, there are regulations that intend to protect endangered species. The link between endangered species and human health and welfare is tenuous. The values driving those regulations were not whether the regulations protecting endangered species make humans healthier, but rather, to protect endangered species, since eliminating other species is wrong.

There are civil rights regulations that prevent people from discriminating based on race, religion, and other factors. There is not a huge amount of federal money spent on these regulations. Much of the enforcement of these results from lawsuits in the private sector, but that is an important part of regulation. The three previously mentioned categories, health and safety, environmental, and civil rights, are often grouped together and referred to as social regulation.

In contrast to social regulations, there are transfer regulations. These are regulations issued by agencies that spend money or collect taxes. The regulations these agencies issue lay out how they are going to collect taxes or how they are going to spend money. This is a little different from some of these other types of regulation. Much of the way the money is spent is driven by formulas written into the legislation and then the agency is responsible for issuing regulations that implement and update that formula when they distribute the money. Federal disaster aid is administered in this way and the Federal Emergency Management Administration has to issue a set of regulations and ground rules outlining how people can apply for that disaster aid. These types of regulations elaborate on how the Federal Government spends money.

V. Important Trends in Regulation

Five important trends in regulation are essential to understand. The first major trend is a reduction in certain types of economic regulation. Many graphs of federal spending on industry-specific economic regulation come from a publication called the Regulator's Budget. This is jointly assembled every year and updated by the Mercatus Center and the Weidenbaum Center at Saint Louis University.[12] Money spent on industry-specific economic regulation increased throughout the sixties, but in the seventies it started falling. It bounced up a little bit, and then bounced down, but a big drop-off persisted throughout the 1970s and into the 1980s.

These trends largely reflect the decisions to deregulate prices and entry in transportation industries like railroads, trucking, airlines, communications, telecommunications, and certain energy industries. For example, the Federal Government no longer controls the price of natural gas. The price is set through competition in the market. Much of the scholarly research in the 1960s and the 1970s on a cluster of infrastructure industries demonstrated that the principal effect of government regulation in these competitive industries was to enforce cartels, enforce monopolies, and overcharge consumers. This is why the two principal political figures who pushed the deregulation of those industries in the 1970s, particularly the transportation industry, were President Jimmy Carter and Senator Ted Kennedy. Senator Ted Kennedy was the principal sponsor of the airline deregulation bill.

The figures on regulatory personnel show a similar effect because there was a big reduction of regulatory personnel who were involved in industry-specific regulation. Almost all of the academic research, whether it is by economists who are on the left, the right, or in the middle, agreed on the impact of this regulation. In studies by the Brookings Institution in Washington D.C., economists suggested that deregulation benefits consumers with large price decreases and other significant benefits, such as improvements in the quality and timeliness of service. When economists have quantified the effects in 1995 dollars, it totaled around $60 billion per year. At current prices, these figures rise to approximately $75 to $80 billion in annual benefits that consumers get from lower prices and better service as a result of the deregulation that has occurred in these industries. This is driving the reduction in spending and personnel on economic regulation.

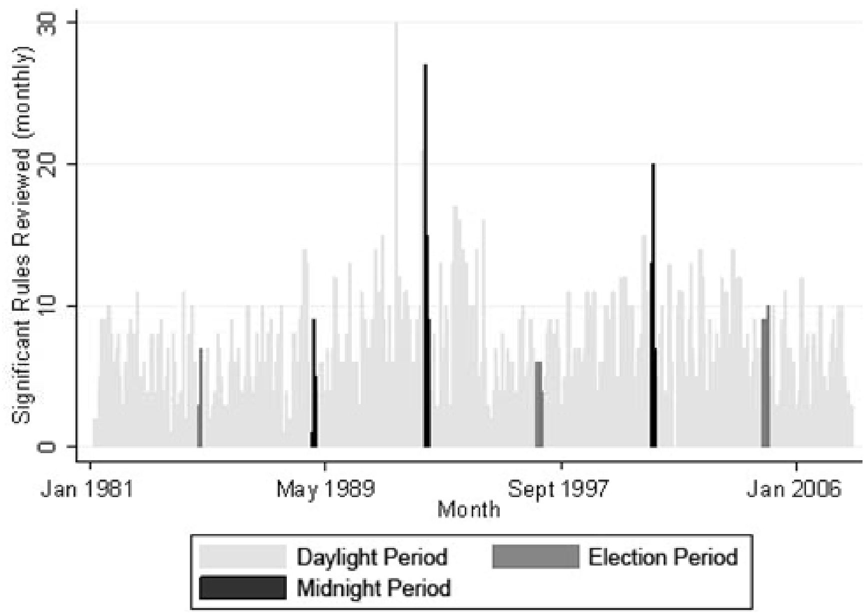
The OMB's guidance documents for regulatory agencies also encapsulate the conventional wisdom of economists with regard to government regulation of prices. In terms of service in competitive industries, the OMB guidance to agencies says, "in light of both economic theory and actual experience a particularly demanding burden of proof is required to demonstrate the need for any of the following types of regulations."[13] Essentially, regulations of prices, quantities, quotas and aspects of industries could be competitive. The highest levels of officials in the Federal Government who review federal regulation accept that economic regulation that puts government in the business of enforcing cartels and monopolies does not benefit consumers. Such types of regulation should raise suspicions, unless there is some other public interest or reason besides the effects on prices and consumer welfare. Ultimately, one major trend is the sizeable reduction in economic regulation.

The second trend is a very large increase in social regulation, particularly in the areas of health and safety regulation and environmental regulation. Federal spending on social regulation has continued to gradually increase since President Nixon's term, with only a slight decline under President Reagan. Similarly, the number of people involved in social regulation has generally increased over time with the only anomaly happening during the Reagan years. The findings in these reports do not reflect the furious battles in Washington D.C. over environmental regulation, which along with health and safety regulation, have continued to gradually increase.

The third trend is an increase in national security regulation. This type of regulation has seen the biggest jump of any kind of regulation. Yet again, most of that surge relates to the federalization of the screening workforce in airports. After 9/11, national security related regulations increased, whereby either new regulations came into existence, or existing regulations became more stringent. The same type of pattern can be observed when examining Homeland Security regulatory personnel. President Obama's 2009 budget provides projections through 2010 and for an increase in funding of the Department of Homeland Security, though the rate of increase is slightly lower than during the President George W. Bush's Administration.[14] It seems the increase in national security regulation was not an anomaly that occurred only under President George W. Bush, but rather that, Homeland Security spending is permanent.

The fourth trend is the appearance of midnight regulation. This has been researched by a number of colleagues at the Mercatus Center, including one who even spent some time in the Federal Government trying to curb this trend. There are various ways of measuring this, but the general phenomenon is the tendency for regulatory activity on the federal level to become concentrated in the final quarter of a President's final year in office, hence the term midnight regulation. Much of this regulation occurs after the election and before inauguration day, as seen in Figure 2.[15]

FIGURE 2: NUMBER OF SIGNIFICANT RULES REVIEWED AND MONTH RECEIVED



Source: Patrick A. McLaughlin, "Empirical Tests for Midnight Regulations and Their Effect on OIRA Review Time."[16]

This trend is consistent among both Democratic and Republican Presidents, so it is not a partisan trend. It tends to be the most common either at the end of a president's eight year term, because then the President is really a lame duck and will not be serving again, or when control of the

Presidency switches from one party to another. The term midnight regulation was likely coined during the Carter Administration and has only really been examined since that time, but each President partakes in this activity to some degree or another at the end of his second term.[17]

Midnight regulation is not inherently good or bad. The real issue is whether each President is issuing good, well thought-out regulations toward the end of his term. Some argue that trying to do a whole lot in that short period of time may be a bad thing for two reasons. First, since most of that activity occurs between Election Day and inauguration day, the outgoing president is not accountable to anybody for his actions.[18] From a democratic perspective, we must evaluate the merits of surges of activity in an administration when it is very clear the President is leaving office and can do whatever he wants without fear of penalty from the electorate. The other reason to think carefully about whether midnight regulation is advantageous is the need for time to review regulations at the Office of Management and Budget. The OMB is responsible for analyzing regulation carefully to make sure that agencies understand the costs as well as the benefits. If agencies are trying to do too much at one time, they may not be thinking carefully about what they are doing. Similarly, the reviewers in the administration become swamped with a lot of work at the same time and may not be able to think as carefully about it as they normally would.[19]

Substantial regulations that have a large effect on the economy are referred to in federal regulatory parlance as "economically significant regulations." This term refers to regulations that have an economic impact of more than $100 million, measured in terms of costs, benefits, or federal spending.[20] The midnight regulation phenomenon holds true for economically significant regulations as well. Figures about economically significant regulations are only available since 1981 because it was Reagan's executive order that created the classification called economically significant regulations. President George H.W. Bush, President Clinton, and President George W. Bush all saw a large spike in economically significant regulations at the end of their Presidential terms.[21]

This is problematic because a quick examination of the resources available to the office charged with reviewing these regulations for the President, the Office of Information and Regulatory Affairs, shows that its budget has pretty much declined steadily from its original level of around $10 million in 1981. This figure grew a little bit under Reagan because Reagan was a strong proponent of this kind of review, and increased a little under George W. Bush. But, generally, the Office of Information and Regulatory Affairs has seen declining resources to review regulations even though the number of people in that office has been fairly constant in any given year.[22]

With these big spikes in regulation concentrated in one quarter, it is logical to assume that the people who are supposed to review these regulations for the President are not able to spend as much time on each economically significant regulation during the midnight period, as they spend at any other time.

As seen in Figure 2, under President George W. Bush, the amount of midnight regulation seems to be lower than under President Clinton or President George H.W. Bush. One reason for this is that the White House Chief of Staff, Joshua Bolten, issued a memo toward the end of the Administration telling federal agencies that the White House would be clamping down on midnight regulations. All proposals of new regulations would have to be submitted by June in order to be able to be processed by the end of the presidential term. Consequently, what happened under President George W. Bush is that midnight regulation was smoothed out a little bit, as some of that regulatory activity was pushed back into the summer and spring of the election year, rather than having it all concentrated at the end of the election year. Susan Dudley, a former colleague at the Mercatus Center, who headed the Office of Information and Regulatory Affairs for the last two years of the Bush Administration, deserves much of the credit for the research on midnight regulation. She has written on midnight regulation and entered the Bush Administration committed to trying to reduce the effects of midnight regulation.

The fifth trend is the probable increase in regulation of financial companies as a result of the recent financial crisis. The important thing to keep in mind is that there will be two kinds of regulation of financial companies. Some regulations will relate to things that people think might have caused the financial crisis. For example, there are contracts called credit default swaps, which are essentially a way of buying insurance when you own a portfolio of mortgages and allows you to hedge against some of the risk that those mortgages will default. Some people think that these played a role in the financial crisis and there have been moves to require that all credit default swaps have to be traded on exchanges where they are more public and more highly regulated.[23]

Another example is the proposal floating around to give the Federal Deposit Insurance Corporation (FDIC) the authority to shut down financial firms that are close to being insolvent even if they are not banks. The FDIC would be allowed to wind them down the same way that the FDIC shuts down banks that are insolvent or close to being insolvent. Some people think if the FDIC had possessed that authority, the FDIC might have caught some of these financial firms before they lost so much money, and therefore negating the need for a bail out.[24]

On the other hand, we are also going to see increased financial regulation that has nothing to do with the causes of the financial crisis. For example, there is a proposal to create a Financial Consumer Product Safety Commission that will evaluate all financial products and tell consumers which financial products are safer for consumers to buy.[25] Aside from the merits of this proposal, it is important to keep in mind that this is a proposal that has been around for several decades. People in Washington D.C. have wanted to do this before, and the financial crisis is simply an excuse for doing something that they wanted to do anyway.

Similarly, those who use credit cards may have read the inserts that come in credit card bills and tell you how the terms of credit card agreements are going to change. In some ways, changes may make things better for consumers; in other ways, it may make things worse. These changes are the result of new federal regulations.[26] The idea behind federal regulations on certain types of credit card companies has been floating around for quite some time, and the financial crisis was just an excuse to enact them.

VI. CONCLUSION

There are two conclusions we can draw from these trends. First, regulation is a growth industry. For those who are either students in public policy programs or interested in public policy that means that there is an ever-increasing demand for people who understand how to assess and analyze the effects of regulation. The second is that there are ways that the public can get information in front of regulatory agencies that may affect the decisions of regulatory agencies. Therefore, all hope is not lost because there are opportunities for all of us to be involved in the regulatory process in one way or another, and hopefully create better regulatory decisions.

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